

ORIGINAL

MEMORANDUM



0000112630

RECEIVED

2010 JUN -3 A 10:07

TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

ATTACHED COPY DIVISION
DOCKET CONTROL

DATE: June 3, 2010

RE: STAFF REPORT FOR THE GRAHAM COUNTY ELECTRIC COOPERATIVE, INC. APPLICATION FOR APPROVAL OF A LOAN (DOCKET NO. E-01749A-10-0071)

Attached is the Staff Report for Graham County Electric Cooperative, Inc.'s application for approval of a loan. Staff recommends approval, with conditions.

Any party to this proceeding who wishes may file comments to the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before June 14, 2010.

SMO:PMC:tdp

Originator: Pedro M. Chaves

Arizona Corporation Commission
DOCKETED

JUN - 3 2010

DOCKETED BY	
-------------	--

Service List for: Graham County Electric Cooperative, Inc
Docket No. E-01749A-10-0071

Mr. John Wallace
Grand Canyon State Electric Cooperative Association, Inc.
120 N. 44th Street, Suite 100
Phoenix, Arizona 85034

Mr. Steve Lines
Graham County Electric Cooperative, Inc.
Post Office Drawer B
Pima, Arizona 85543

**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

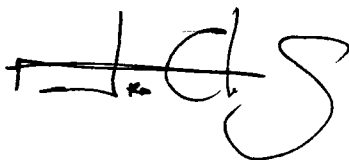
**GRAHAM COUNTY ELECTRIC COOPERATIVE, INC.
DOCKET NO. E-01749A-10-0071**

APPLICATION FOR APPROVAL OF A LOAN

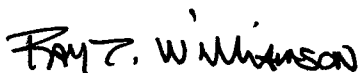
JUNE 3, 2010

STAFF ACKNOWLEDGMENT

The Staff Report for Graham County Electric Cooperative, Inc, Docket No. E-01749A-10-0071 is the responsibility of the Staff members listed below. Pedro M. Chaves is responsible for the review and financial analysis of the Company's application. Ray Williamson is responsible for the engineering and technical analysis.

A handwritten signature in black ink, appearing to read 'Pedro M. Chaves', with a stylized, large 'S' at the end.

PEDRO M. CHAVES
PUBLIC UTILITIES ANALYST III

A handwritten signature in black ink, appearing to read 'Ray T. Williamson', with a stylized, large 'S' at the end.

RAY WILLIAMSON
UTILITIES ENGINEER

EXECUTIVE SUMMARY
GRAHAM COUNTY ELECTRIC COOPERATIVE, INC.
DOCKET NO. E-01749A-10-0071

On February 26, 2010, Graham County Electric Cooperative, Inc. ("GCEC" or "Cooperative"), an Arizona class "A" public service corporation and non-profit, member-owned cooperative located in Graham County Arizona, filed an application requesting approval of a loan to complete GCEC's five-year construction work plan ("CWP").

The Cooperative requests Commission authorization for long-term financing in an amount of \$9,687,550 from the National Rural Utilities Cooperative Finance Corporation ("CFC"). GCEC further requests Commission authorization to execute a mortgage to secure the CFC loan.

As of September 30, 2009, GCEC had \$1,813,368 in unused financing authorizations, approved by Decision No. 66382.

GCEC's capital structure, as of September 30, 2009, consisted of 1.1 percent short-term debt, 57.8 percent long-term debt, and 41.1 percent equity. Issuance of a 30-year \$9,687,550 amortizing loan at 7.6 percent per annum, in addition to issuance of a 30-year \$1,813,368 amortizing loan at 7.6 percent per annum, would result in a pro forma capital structure composed of 1.0 percent short-term debt, 68.9 percent long-term debt and 30.1 percent equity.

Staff's pro forma debt service coverage ("DSC") ratio is 1.29. This result suggests that projected operating results are sufficient to meet all obligations.

Staff concludes that issuance of the proposed debt financing for the purposes stated in the application is within GCEC's corporate powers, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide services.

Staff recommends that the Commission authorize GCEC to incur interim financing in an amount not to exceed \$9,687,550 million from the CFC to finance its CWP.

Staff further recommends that any authorization to incur debt granted in this proceeding terminate on December 31, 2015.

Staff further recommends authorizing GCEC to engage in any transactions and to execute any documents necessary to effectuate the authorizations herein granted.

Staff further recommends that copies of the executed loan documents be filed with Docket Control within 30 days of execution.

TABLE OF CONTENTS

	<u>PAGE</u>
INTRODUCTION.....	1
BACKGROUND.....	1
PUBLIC NOTICE.....	1
PURPOSE AND DESCRIPTION OF THE PROPOSED FINANCING.....	1
ENGINEERING ANALYSIS.....	2
FINANCIAL ANALYSIS.....	2
CAPITAL STRUCTURE	2
DSC	3
ENCUMBRANCE	3
COMPLIANCE	3
CONCLUSION AND RECOMMENDATIONS.....	4

SCHEDULES

Financial Analysis.....	PMC-1
-------------------------	-------

ATTACHMENTS

Engineering Report	Attachment A
Notice.....	Attachment B

INTRODUCTION

On February 26, 2010, Graham County Electric Cooperative, Inc. ("GCEC" or "Cooperative") filed an application requesting approval of a loan to complete its five-year construction work plan ("CWP")¹.

BACKGROUND

GCEC is an Arizona class "A" public service corporation and non-profit, member-owned cooperative located in Graham County, Arizona.

GCEC provided electric service to an average of 7,233 residential customers in 2008. The residential customers used an average of 830 kWh per month. GCEC had 648 irrigation customers and 765 commercial customers. GCEC had 15 large commercial customers and 3 public street and highway lighting customers. In 2007 and 2008, GCEC connected 711 new services. The new services averaged around 355 new services per year.

GCEC's current rates were approved in Decision No. 70289, dated April 4, 2008.

As of September 30, 2009, GCEC had \$1,813,368 in unused financing authorizations, approved by Decision No. 66382, dated October 6, 2003.

PUBLIC NOTICE

With the application, the Cooperative filed an affidavit of publication verifying public notice of its financing application. The Cooperative published notice of its financing application in the *Eastern Arizona Courier* on January 6, 2010. The *Eastern Arizona Courier* is a newspaper printed and published bi-weekly in Graham County.

PURPOSE AND DESCRIPTION OF THE PROPOSED FINANCING

The Cooperative requests that the Commission authorize it to secure CWP financing in an amount of \$9,687,550 from the National Rural Utilities Cooperative Finance Corporation ("CFC"). GCEC requests an accelerated approval process to allow the Cooperative to take advantage of lower pricing and save its member/customers thousands of dollars on its CWP.²

GCEC expects a thirty-year term for the CFC loan, with principal and interest payments due quarterly. The interest rate will be determined at the time the funds are drawn and the loan funds will be drawn when needed to complete the various projects. As of April 29, 2010, CFC rates for GCEC's \$9,687,550 5-Year CWP vary between 3.45 percent and 7.6 percent, depending on the re-pricing date for the CFC loan, as shown in Table 1, below.

¹ The CWP is for the years 2010 through 2014.

² GCEC's application, page 2.

Table 1

CFC interest rates (as of 4/29/2010)	
1-Year:	3.45%
2-Year:	3.55%
3-Year:	4.15%
4-Year:	4.70%
5-Year:	5.20%
10-Year:	6.60%
30-Year:	7.60%

CFC loans with a re-pricing provision have an initial fixed interest rate that is dependent upon the number of years selected for the initial period. After the initial period, the interest rate is re-priced (i.e., a new fixed interest rate is established) for the remainder of the 30-year loan. For example, if the Cooperative chooses ten-year re-pricing, the loan would have a fixed rate of 6.60 percent for ten years; then, the interest rate is re-priced at a fixed rate for the remaining 20 years.

ENGINEERING ANALYSIS

Staff's Engineering Report is attached. Staff concludes that the projects included in the proposed CWP are appropriate and their associated costs appear to be reasonable. Staff makes no "used and useful" determination in this proceeding. Treatment of the proposed plant improvements for rate-making purposes is deferred to a future rate proceeding.

FINANCIAL ANALYSIS

Staff's analysis is illustrated in Schedule PMC-1. Column [A] reflects GCEC's audited financial information for the year ended September 30, 2009. Column [B] presents pro forma financial information that modifies Column [A] to reflect issuance of the proposed \$9,687,550 debt financing amortized for 30 years at 7.6 percent, and \$1,813,368 in previously authorized debt amortized for 30 years at 7.6 percent.

Capital Structure

As of September 30, 2009, GCEC's capital structure consisted of 1.1 percent short-term debt, 57.8 percent long-term debt, and 41.1 percent equity. Issuance of a 30-year \$9,687,550 amortizing loan at 7.6 percent per annum in addition to issuance of a 30-year \$1,813,368 amortizing loan at 7.6 percent per annum would result in a pro forma capital structure composed of 1.0 percent short-term debt, 68.9 percent long-term debt and 30.1 percent equity.

Staff usually considers equity at 40 percent of total capital as the minimum financially prudent capital structure for an investor owned utility with access to the capital markets and 30 percent of total capital as the minimum financially prudent capital structure for a member-owned cooperative.

DSC

Debt service coverage ratio ("DSC") represents the number of times internally generated cash will cover required principal and interest payments on short-term and long-term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations. A DSC less than 1.0 means that debt service obligations cannot be met by cash generated from operations and that another source of funds is needed to avoid default.

Schedule PMC-1, Column [A] shows that for the year ended September 30, 2009, GCEC had a 2.14 DSC. The pro forma DSC for GCEC, under the scenario described above for Columns [B], is 1.29. The pro forma DSC for the Column [B] scenario is a stringent test in that GCEC does not expect to draw all of these funds immediately. This DSC result suggests that operating results are sufficient to meet all obligations.

CFC has a coverage ratio requirement that requires GCEC to achieve an average DSC ratio of 1.35 in two out of three years.³

In its 10-year financial forecast, the Cooperative projects that DSC ratios will not decline to less than 1.54. These projections suggest that operating margin will be sufficient to meet CFC's DSC covenant.

Encumbrance

As indicated by GCEC, CFC will require that all of the assets of the Cooperative be held as security for the loan as it has for all previous loans to the Cooperative.⁴

A.R.S. § 40-285 requires public service corporations to obtain Commission authorization to encumber certain utility assets. The statute serves to protect captive customers from a utility's act to dispose of any of its assets that are necessary for the provision of service; thus, it serves to preempt any service impairment due to disposal of assets essential for providing service.

Pledging assets as security typically provides benefits to the borrower in the way of increased access to capital funds or preferable interest rates.

COMPLIANCE

There are no compliance issues with GCEC

³ The covenants define the average DSC ratio as the average of the borrower's (GCEC) two highest annual DSC ratios during the most recent three calendar years.

⁴ GCEC's application, page 2.

CONCLUSION AND RECOMMENDATIONS

Staff concludes that the CWP projects are appropriate and that the related cost estimates are reasonable.

Staff concludes that issuance of debt financing for the purposes stated in the application is within GCEC's corporate powers, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide services.

Staff recommends that the Commission authorize GCEC to incur financing in an amount not to exceed \$9,687,550 from the CFC to finance its CWP, at an interest rate not to exceed the current CFC rate at the time the loan is executed.

Staff further recommends that any authorization to incur debt granted in this proceeding terminate on December 31, 2015.

Staff further recommends authorizing GCEC to engage in any transactions and to execute any documents necessary to effectuate the authorizations herein granted.

Staff further recommends that copies of the executed loan documents be filed with Docket Control within 30 days of execution.

FINANCIAL ANALYSIS

Selected Financial Information

		[A] ¹ 9/30/2009		[B] ² Pro Forma	
1	Operating Income	\$	2,163,050	\$	2,163,050
2	Depreciation & Amort.		1,026,746		1,026,746
3	Income Tax Expense		0		0
4					
5	Interest Expense		1,151,835		2,022,333
6	Repayment of Principal		340,056		444,019
7					
8					
9					
10					
11	DSC				
12	[1+2+3] ÷ [5+6]		2.14		1.29
13					
14					
15	Capital Structure				
16					
17	Short-term Debt		340,056 1.1%		444,019 1.0% ³
18					
19	Long-term Debt		17,997,535 57.8%		29,394,490 68.9%
20					
21	Common Equity		12,820,663 41.1%		12,820,663 30.1%
22					
23	Total Capital	\$	31,158,254 100.0%	\$	42,659,172 100.0%
24					
25					
26					

¹ Column [A] is based on audited 2009 financial information for the year ended September 30, 2009.

² Column [B] is Column [A] modified to reflect issuance of the proposed \$9,687,550 loan amortized for 30 years at 7.6 percent. Column [B] also modifies Column [A] to reflect \$1,813,368 previously authorized long-term debt financing amortized for 30 years at 7.6 percent.

³ Pro Forma short-term debt represents the annual principal portion of the proposed loan and previously authorized financing.

MEMORANDUM

TO: Pedro M. Chaves
Public Utilities Analyst
Utilities Division

FROM: Ray T. Williamson, C.E.M.
Utilities Engineer
Utilities Division



DATE: May 15, 2010

RE: GRAHAM COUNTY ELECTRIC COOPERATIVE'S FINANCING APPLICATION
(DOCKET NO. E-01749A-10-0071)

Graham County Electric Cooperative ("GCEC") filed an application ("Application") with the Arizona Corporation Commission ("Commission") for authorization for a loan. The application, if approved, would allow GCEC to borrow \$9,687,550 from the National Cooperative Finance Corporation ("CFC") that would be used to finance construction of plant in accordance with GCEC's five-year construction work plan.

Customer and Load Growth

GCEC provided electric service to an average of 7,233 residential customers in 2008. The residential customers used an average of 830 kWh per month. GCEC had 648 irrigation customers and 765 commercial customers. GCEC had 15 large commercial customers and 3 public street and highway lighting customers. In 2007 and 2008, GCEC connected 711 new services. The new services averaged around 355 new services per year.

GCEC predicts that by 2014, it will provide electric service to an average of 8,182 residential customers using an average of 856 kWh per month. They expect to have 627 irrigation customers, 839 commercial customers and 13 larger commercial customers, and 3 public street lighting customers. The projected net gain in customers is around 1,000.

Between 2004 and 2008, purchases and sales of electricity have risen from 132.3 GWh to 157.2 GWh. The system peak demand reached its highest at 42.1 MW in July of 2007. Losses on the system increased from 8.2 percent in 2004 to a high of 8.86 percent in 2006. Losses decreased in 2007 and in 2008 the losses had decreased to 7.60 percent. Those losses are less than the Rural Utilities Service ("R.U.S.") guidelines of 10 percent losses on the system.

GCEC has implemented a number of measures to reduce system losses. They include:

1. Disconnection or removal of distribution transformers that are not serving loads if it is economical to do so.

2. Transformers are prevented from being over-excited by maintaining proper voltage and correct tap connections.
3. Good load balancing on three-phase lines is maintained to keep losses at a minimum.
4. Capacitors are used to provide voltage support, power factor correction and reduce line losses due to a reduction in line current.
5. Metering for commercial and industrial consumers is checked for proper connections, registration, and multipliers. Employees are trained to watch for and report bypassing or tampering with meters.
6. Conductors and transformers are sized to properly serve loads economically.

GCEC has averaged 2.95 outage-hours per customer over the last five years. This included a high of slightly over 4 outage-hours in 2005 and a low of less than 1 outage-hour in 2008. These outage-hours are less than the R.U.S. guidelines of 5 outage-hours per customer.

Review of GCEC's Five-Year Construction Work Plan (2010-2014)

In assessing the Company's future capital expenditures, Staff utilized the following criteria:

- Does GCEC adequately address the needs of the projected customer and load growth in GCEC's service territory.
- Do the capital expenditures on transmission and distribution infrastructure upgrades and new additions appear appropriate and reasonable in meeting the Company's future native load requirements in a reliable and cost effective manner?

Staff has reviewed GCEC's total capital expenditures for Transmission and Distribution included in its financing application.

GCEC has requested approval of a loan for \$9,687,550 from the CFC to help finance GCEC's five-year Construction Work Plan. A total of \$8,964,050 will be used for distribution system improvements. The distribution system portion is 92.5 percent of the loan funds. The remainder of the funding, totaling \$723,500, will be used to replace poles and cross arms in the transmission system.

A large portion of the funds, \$2.9 million, will be used for two new substations: the Pima Substation and the Talley Substation. Another \$1 million will be used for automated meter reading. An additional \$590,000 will be allocated to transformers and \$1.7 million will be used for 1,000 new distribution poles. Finally, \$1.1 million will be used for new underground and overhead lines.

GCEC's projected expenditures appear to be appropriate and reasonable given the level of projected load growth. These expenditure levels are comparable to levels from past years.

Conclusions and Recommendations

Based on Staff's review of GCEC's proposed projects in the GCEC Five-Year Construction Work Plan, Staff believes that GCEC's proposed capital expenditures are appropriate to meet the needs of GCEC's existing customers, the needs of new customers, and the system reliability needs. Staff further believes that the expenditure levels associated with the projects proposed by GCEC appear to be reasonable. This conclusion, however, does not imply any specific treatment of rate base for rate-making purposes in GCEC's future rate filings.

RTW:lhv

STATE OF ARIZONA)
COUNTY OF GRAHAM) ss.

**PUBLIC NOTICE
OF
AN APPLICATION FOR
AN ORDER
AUTHORIZING THE
BORROWING OF \$9,687,550
BY GRAHAM
COUNTY ELECTRIC
COOPERATIVE, INC.**

Graham County Electric Cooperative, Inc. ("Company") filed an Application with the Arizona Corporation Commission ("Commission") for an order authorizing Applicant to borrow \$9,687,550 for thirty-five (35) years to finance construction. The application is available for inspection during regular business hours at the office of the Commission in Phoenix, Arizona, and the Company's offices located at 9 West Center Street, Pima, Arizona.

Intervention in the Commission's proceedings on the application shall be permitted to any person entitled by law to intervene and having a direct substantial interest in this matter. Persons desiring to intervene must file a Motion to Intervene with the Commission which must be served upon applicant and which, at a minimum, shall contain the following information:

1. The name, address and telephone number of the proposed intervenor and of any person upon whom service of documents is to be made if different than the intervenor.

2. A short statement of the proposed intervenor's interest in the proceeding.

3. Whether the proposed intervenor desires a formal evidentiary hearing on the application and the reasons for such a hearing.

4. A statement certifying that a copy of the Motion to Intervene has been mailed to Applicant.

The granting of Motions to Intervene shall be governed by A.A.C. R14-3-105, except that all Motions to Intervene must be filed on, or before, the 15th day after this notice.

Req. Graham County Electric Cooperative, Inc.
Published: January 6, 2010, in the Eastern Arizona Courier, Safford, Arizona 85546.

AFFIDAVIT OF PUBLICATION

SHERRY L. ENGLISH

being first

duly sworn, deposes and says: That (he) (she) is the Agent to the Publisher of the EASTERN ARIZONA COURIER newspaper printed and published bi-weekly in the County of Graham, State of Arizona, and of general circulation in the city of Safford, County of Graham, State of Arizona and elsewhere, and the hereto attached

APPLICATION FOR AN
ORDER AUTHORIZING
THE BORROWING OF
\$9,687,550

was printed and published correctly in the regular and entire issue of said EASTERN ARIZONA COURIER for 1 issues, that the first was

made on the 6th day of JANUARY 20 10

and the last publication thereof was made on the 6th day of

JANUARY 20 10

that said

publication was made on each of the following dates, to wit:
01/06/10

Request of GRAHAM CTY UTILITIES-LGLS

EASTERN ARIZONA COURIER

By

Sherry L. English

Subscribed sworn to before me this 6th day of JANUARY 20 10

Notary Public and for the County of Graham, State of Arizona
My Commission Expires: *Dec. 11, 2010*